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SIPDIS

DEPARTMENT FOR SCA/CEN AND EB

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TAGS: [ECON](#) [EFIN](#) [EAID](#) [EINV](#) [ETRD](#) [KCRM](#) [SOCI](#) [UZ](#)
SUBJECT: IMF MILDLY UPBEAT ON UZBEK ECONOMY

REF: TASHKENT 531

Classified By: Poloff Robert McCutcheon for reasons 1.4 (b, d).

¶1. (SBU) SUMMARY: On May 15 Sena Eken, Assistant Director of the IMF's Middle East and Central Asia Department, briefed a select group from Tashkent's international community on the conclusions reached by her IMF team during two weeks of Article IV consultations with Uzbek Government officials. This briefing provided a preview of the IMF staff report on Uzbekistan that is expected to be published in July. Although assessing the Uzbek economy to be much stronger than 5-6 years ago, the IMF believes Uzbek predictions for economic growth in 2008 are overly optimistic. Official figures show relatively high inflation of 11.5-12 percent, but the actual figure may be much higher. The IMF recommends the exchange rate for the soum be allowed to appreciate and that banks be allowed to divest themselves of non-banking functions. As in the past, the Uzbek Government provides economic data to the IMF subject to a non-disclosure agreement. Furthermore, the IMF does not attempt to analyze the social and political impacts of economic reforms. END SUMMARY

STRONG ECONOMIC PERFORMANCE IN 2007, BUT PROBLEMS REMAIN

¶2. (SBU) Reviewing 2007 economic performance as reported by the Uzbek Government, Eken cited a growth rate of 9.5 percent and a large current account surplus corresponding to 19 percent of GDP. The balance of payments continued strong with a surplus of 7.5 billion US dollars. The official debt ratio is now 17-18 percent of GDP and is likely to fall below 15 percent in the next few years.

¶3. (SBU) During 2007 the Central Bank faced challenges controlling the money supply. Rapid monetary expansion continued, and adjusted domestic commodity prices had their effect on price indices. This together with wage increases led to a relatively high rate of inflation, which the Government estimated to be 11.5-12 percent annually. Given the high GDP deflation numbers, however, the real rate of inflation could have been even higher.

¶4. (SBU) In 2008 the Uzbek Government hopes to maintain an 8 percent growth rate, largely from exports and the strength of industrial production. Eken said she considers this goal to be overly ambitious given current Uzbek

policies and unachievable unless those policies change.

¶5. (SBU) Eken expects the current account will remain large at 17 percent of GDP due to high commodity prices. Uzbek authorities hope that tighter monetary policy will lead to lower inflation, although the prices of imported goods are expected to rise. Eken noted that Uzbekistan is relatively insulated from international financial markets such that even a 10 percent drop in commodity prices probably would lower Uzbekistan's current account by only 1 percent. If achieved, a lower rate of inflation should make more money available for social spending and infrastructure improvements.

¶6. (SBU) Eken said to date the Uzbek Government continues to use its Fund for Reconstruction and Development (FRD), established in 2006 and funded at approximately 1 billion US dollars in 2007, primarily to support the Central Bank of Uzbekistan's efforts to sterilize excess money supply - i.e., it is used as a collection pool to store funds that, if allowed to circulate, would change the money supply. To date the FRD has not been used for funding and implementing development projects.

IMF RECOMMENDATIONS

¶7. (SBU) Eken said that although the Uzbek economy is much stronger than it was 5-6 years ago, the IMF will be making a number of recommendations. Most importantly, the IMF recommends that since there are continuing indications that the soum is significantly undervalued, the nominal exchange rate should be allowed to appreciate. If this does not happen, it will happen on a de-facto basis due to inflation. The Uzbek authorities are resistant to this suggestion.

¶8. (SBU) The IMF also sees a number of areas that need to be addressed in the banking sector. Most importantly, the IMF believes that banks must be allowed to divest themselves of non-core functions such as reporting transactions above a threshold level to tax authorities. According to Eken, this is being debated at the highest levels in the Uzbek Government and could become a reality once the overall tax system improves and becomes more efficient. In this regard the IMF is somewhat sympathetic to the Uzbek explanation that it suspended some provisions of its anti-money laundering (AML) legislation last year due to technical reasons. Eken reported that the IMF has offered assistance in carrying out a full review of AML measures later this year. (The Uzbek authorities have yet to take the IMF up on this offer.)

¶9. (SBU) Eken said the IMF continues to recommend loosening the overly restrictive Uzbek trade regime. The IMF recommends acceleration of Uzbekistan's accession to the WTO, continued fiscal reforms in support of the private sector, and consolidation of extra-budgetary accounts so that the role of public programs can be evaluated. Comment: Loosening of the restrictive trade regime is particularly important in solving many of Uzbekistan's most immediate problems. End comment.

¶10. (SBU) Finally, the IMF continues to emphasize the urgent need for better quality data in almost all areas, in particular regarding price indices. At present two IMF technical assistance projects are in place to assist Uzbek authorities in this task. The IMF also is urging Uzbek authorities to improve data sharing between different government agencies.

FOOD PRICES

¶11. (SBU) Responding to a question on whether Uzbekistan has tried to control rising food costs through price

controls or export bans, Eken said that some restrictions were put in place at the end of 2007, in particular as concerns the price of flour and cooking oil. Nevertheless, the IMF was unable to determine whether Uzbek authorities had instituted export controls. Some authorities say controls have been put in place, whereas others contradict this. Eken said that overall Uzbekistan has not seen the same level of food price increases that have been experienced in other countries.

LARGER CURRENCY DENOMINATIONS -- DON'T HOLD YOUR BREATH

¶12. (SBU) For nearly ten years the largest denomination currency note in Uzbekistan has been 1000 soum - currently worth about 75 US cents. Asked whether there are plans to issue higher denomination notes, Eken replied that Uzbek authorities have made a conscious decision to maintain the 1000 soum note as its largest denomination currency. The rationale behind this decision is to encourage bank deposits by discouraging large withdrawals. Furthermore, the government says issuing larger denomination notes would feed fears of inflation.

COMMENT

¶13. (SBU) This year's briefing on the IMF's Article IV consultations differed from previous years in that it was given behind closed doors to a small group of representatives from foreign embassies and international organizations. This allowed for a more frank discussion than in previous years, but at several points Eken restrained team members from divulging precise figures. The IMF is still subject to an agreement whereby the Uzbek Government provides the IMF with economic data under the restriction that these data are for internal IMF use only. Moreover, the IMF staff report can be released only after Uzbek authorities permit its release. Although this permission is routinely given, it causes considerable delay in publication of the IMF report. As it stands, the report from this year's IMF Article IV consultations most likely will be published no earlier than early July.

¶14. (SBU) As is its standard practice, the IMF focused its attention on macroeconomic fiscal parameters. The IMF neither intends nor attempts to analyze the social and political impacts of economic reforms.

¶15. (C) The surprisingly positive IMF assessment of Uzbekistan's economic situation has implications for the gradually evolving leadership transition picture (reftel). While it is clear the lack of a vibrant foreign investment climate continues to contribute to low job growth, the rising commodity prices and careful management of foreign exchange reserves are insulating the ruling elites from socio-economic pressures. This probably buys time for the Karimov regime, and puts the burden on us to devise effective approaches to promote economic and political reform.

NORLAND